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No. 02-1569

In the Supreme Court of the United States

AMERICAN TELEPHONE AND TELEGRAPH COMPANY AND LUCENT TECHNOLOGIES INC., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

Section 8118 of the Department of Defense Appropriations Act for Fiscal Year 1988 placed conditions on the use of appropriated funds for fixed-price development contracts. Petitioners successfully bid for and performed a fixed-price development contract that did not meet the conditions imposed by Section 8118. The questions presented are:

1. Whether petitioners are entitled to convert the completed contract from a fixed-price contract to a cost-reimbursement contract.

2. Whether petitioners waived their asserted right to be reimbursed on the basis of cost by failing to seek cost-based reimbursement before performance of the contract began.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-18a) is reported at 307 F.3d 1374. The opinion of the Court of Federal Claims (Pet. App. 21a-32a) is reported at 48 Fed. Cl. 156. The prior en banc opinion of the Federal Circuit (Pet. App. 33a-72a) is reported at 177 F.3d 1368.

JURISDICTION

The judgment of the court of appeals was entered on October 8, 2002. A petition for rehearing was denied on January 27, 2003 (Pet. App. 19a-20a). The petition for a writ of certiorari was filed on April 25, 2003. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. On December 22, 1987, Congress enacted an Act appropriating funds for the Department of Defense (DOD) for Fiscal Year 1988. Pub. L. No. 100-202, 101 Stat. 1329-1. Section 8118 of the Act provided that appropriated funds could not be obligated or expended for major fixed-price development contracts unless the Under Secretary of Defense for Acquisition made a written determination "that program risk has been reduced to the extent that realistic pricing can occur, and that the contract type permits an equitable and sensible allocation of program risk between the contracting parties." 101 Stat. 1329-84. Section 8118 further required DOD quarterly to report to Congress all fixed-price contract awards made under the provision. *Ibid.*

On December 31, 1987, just nine days after Congress enacted Section 8118, the Navy awarded a fixed-price incentive contract to petitioner American Telephone and Telegraph Company (AT&T) for the development of a new anti-submarine sonar system. DOD did not previously make the determination specified in Section 8118. Although the Navy determined AT&T's proposal to be technically inferior to that of a competitor, the Navy awarded the contract to AT&T based upon the significantly reduced price offered by AT&T in the final days of negotiation. A competitor subsequently protested the contract award, asserting, *inter alia*, that AT&T's price was erroneous. *Gould, Inc. Ocean Sys. Div.*, B-229965, 88-1 CPD § 457 (May 16, 1988). AT&T defended the award, asserting in part that it understood the risks of the contract and that the pricing was accurate. Pet. App. 4a. At no time during the solicitation, contract award, or subsequent bid protest, did

AT&T ever object to the contract being awarded on a fixed-price basis or assert that it was entitled to a cost-reimbursement type contract. *Id.* at 11a-12a, 31a, 47a. AT&T likewise never requested the Navy to make the determination specified in Section 8118.

AT&T performed the contract at a cost of $91 million, well in excess of the final adjusted contract price of approximately $34.5 million. In 1992, five years after performance of the contract began, AT&T filed a claim with the contracting officer asserting that the contract was invalid based upon the government's failure to comply with Section 8118. After the contracting officer denied the claim, AT&T filed suit in the Court of Federal Claims. AT&T alleged that, as a result of the government's failure to comply with Section 8118, AT&T was not bound by the fixed-price terms of the contract and was instead entitled to reformation of the contract to a cost-reimbursement contract or a recovery of their costs and a reasonable profit under equitable principles of *quantum meruit.*

2. The trial court held that the failure to comply with Section 8118 rendered the entire contract void *ab initio* and might support a *quantum meruit* claim, and certified its ruling for interlocutory appeal. Pet. App. 120a-135a. A divided panel of the Federal Circuit affirmed in part and reversed in part, holding that the contract was void but concluding that *quantum meruit* relief was not available. *Id.* at 75a-103a. Judge Newman dissented from the majority's finding that the contract was void. *Id.* at 97a-103a.

A divided en banc court of appeals held that Section 8118 provided no basis for declaring the contract void *ab initio.* Pet. App. 33a-72a. The court found that Section 8118 imposed only "internal," "supervisory," "oversight" requirements and that Congress specifi-

cally intended to monitor and enforce compliance with Section 8118 through its own oversight powers. *Id.* at 44a-46a. The court also noted that the Federal Circuit's precedents disfavor the invalidation of a contract on the ground of illegality after the contract has been fully performed. *Id.* at 46a-49a. The court therefore remanded the case to the trial court so that AT&T could present "such claims [for relief], if any, that it may have." *Id.* at 49a-50a.

Judges Rader, Mayer, and Lourie concurred, reasoning that Section 8118 did not apply to the contract. Pet. App. 51a-54a.

Judge Plager dissented in part and concurred in part. Pet. App. 55a-72a. In his view, the Navy's violation of Section 8118 rendered the contract void, *id.* at 55a-66a, but AT&T's demand for additional money was "facially nonsensical." *Id.* at 67a. As Judge Plager explained:

> AT&T comes to the court with unclean hands. AT&T is not an innocent bystander being taken advantage of by a predator government. Both the Government and AT&T knew exactly what they were doing when they entered into this deal. It simply defies belief that AT&T was unaware of § 8118 when it purported to contract with the Government or was unaware that the Navy was proceeding with the contract in the manner the Navy did.

Id. at 68a-69a.

On remand, the trial court held that AT&T was not entitled to reformation of the contract. Pet. App. 32a. The trial court concluded that "[t]he same reasoning that led the court of appeals to reject the argument that the RDA contract was void from the start now leads us to say that the contract is enforceable as it stands." *Id.*

at 30a. The court explained that "non-compliance with the statute is not an actionable wrong," and that contractors "cannot claim a protectable interest in the proper application of Section 8118 for Congress intended to give them none." *Ibid.*

3. A divided panel of the Federal Circuit affirmed. Pet. App. 1a-14a. The court of appeals held Section 8118 provides no basis for awarding judicial relief to petitioners. The court reasoned that Section 8118 "is an appropriations oversight provision that envisions enforcement, if any, in the form of legislative spending adjustments in future bills." *Id.* at 7a. The court thus concluded that "Section 8118 simply does not provide implicitly or explicitly for any enforcement of its supervisory and congressional oversight provisions in a judicial forum." *Id.* at 9a.[1]

The court further held that "[i]n view of the facts of this case, [the] court would be forced to conclude that AT&T waived its present arguments even were those arguments to state a valid claim." Pet. App. 11a. The court reasoned that, "[d]espite AT&T's sophistication on these matters," AT&T presented no evidence that it ever sought a cost-reimbursement contract during the contract negotiations. *Id.* at 11a-12a. Under those circumstances, the court held that "the proper time for AT&T to have raised the issues that it now presents was at the time of contract negotiation, when effective remedy was available." *Id.* at 13a.

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[1] The court also affirmed the trial court's rejection of petitioners' contentions that it was entitled to relief based on the Navy's alleged violation of its procurement regulations and directives. Pet. App. 9a-11a. Petitioners do not challenge that holding in this Court.

Judge Newman dissented. Pet. App. 15a-18a. She stated that she did "not know whether this contract warrants relief" but that "[t]he briefs raise factual and legal questions, and equitable aspects, the weight and value of which have never been aired." *Id.* at 18a. Judge Newman stated, however, that she was not "suggest[ing] that government procurement contracts are readily subject to change after performance," since "[t]he law and precedent of contract and procurement require some grave error or mutual mistake or changed circumstances, such as would render it unconscionable for the government to require performance of the original terms." *Id.* at 18a n.2.

ARGUMENT

1. AT&T and its successor in interest, Lucent Technologies, Inc., argue (Pet. 13-27) that they are entitled to recover over $55 million in losses that AT&T sustained in performing the contract at the fixed price, based on the DOD's failure to determine that the contract involved a fair allocation of risk as required by Section 8118. The court of appeals correctly rejected that proposition. Section 8118 bars the expenditure or obligation of DOD appropriated funds for certain "fixed price-type contracts" for the development of a major system or subsystem unless a specified DOD official determines in writing "that program risk has been reduced to the extent that realistic pricing can occur, and that the contract type permits an equitable and sensible allocation of program risk between the contracting parties." § 8118, 101 Stat. 1329-84. The statute also requires the DOD to report to the relevant appropriation committees on a quarterly basis "the contracts which have obligated funds under such a fixed price-type developmental contract." *Ibid.*

There is nothing in the text of Section 8118 that suggests that a contract awarded in violation of the provision is invalid or that the contractor is relieved from the terms of a fully performed contract. As the court of appeals explained, "[t]he language of [S]ection 8118 does not explicitly create a cause of action for enforcement of its expenditure prohibitions." Pet. App. 6a. Rather, Section 8118 "envisions enforcement, if any, through legislative procedures." *Ibid.*

The absence of any right of action to enforce Section 8118 is confirmed by subsequent congressional developments. By its terms, Section 8118 applied only to funds appropriated for Fiscal Year 1988. Four months later, as part of the DOD authorization and appropriations process for Fiscal Year 1989, Congress considered and eventually enacted funding restrictions similar to Section 8118. The Senate Armed Services Committee, addressing a draft successor provision to Section 8118, stated, "[i]t is the intent of the committee that this section be applied in a manner that best serves the government's interests in the long term health of the defense industry, and *that this section not be used as the basis for litigating the propriety of an otherwise valid contract.*" S. Rep. No. 326, 100th Cong., 2d Sess. 105 (1988) (emphasis added). Indeed, rather than providing for a right of action, Congress for Fiscal Years 1990 through 1993 elected to enforce the funding restriction embodied in Section 8118 by instructing the DOD to issue pre-award quarterly reports. Act of Nov. 21, 1989, Pub. L. No. 101-165, § 9048, 103 Stat. 1139; Act of Nov. 5, 1990, Pub. L. No 101-511, § 8038, 104 Stat. 1882; Act of Nov. 26, 1991, Pub. L. No. 102-172, § 8037, 105 Stat. 1179-80; Act of Oct. 6, 1992, Pub. L. No. 102-396, § 9037, 106 Stat. 1910.

For those reasons, petitioners err in asserting (Pet. 18) that the court of appeals' decision "appears to create a *broad, new principle*" that violations of procurement statutes and regulations may not support judicial relief in the absence of an *explicit* right of action. Based on the particular statutory language, structure, and history of the funding restriction in Section 8118, the court of appeals concluded that "Section 8118 simply does not provide *implicitly* or explicitly for any enforcement of its supervisory and congressional oversight provisions in a judicial forum." Pet. App. 9a (emphasis added).[2] That ruling is entirely consistent with the settled principle that a contract that the government unlawfully entered into does not automatically entitle the contractor to judicial relief. *E. Walters & Co.* v. *United States*, 576 F.2d 362, 367 (Ct. Cl. 1978). Thus, "[w]hen a contract or a provision thereof is in violation of law but has been fully performed, the courts have variously *sustained the contract*, reformed it to correct the illegal term, or allowed recovery under an implied contract theory." Pet. App. 16a (quoting *AT&T* v. *United States*, 177 F.3d 1368, 1376 (Fed. Cir. 1999) (en banc)) (emphasis added). Accordingly, courts routinely enforce government contracts even though the government has violated statutes or regulations relating to the procurement or award process. *E.g.*, *United States* v. *New York & Porto Rico S.S. Co.*, 239 U.S. 88, 92-93

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[2] Petitioners mistakenly assert (Pet. i, 2-3, 5-6, 9-10, 13, 21) that Congress enacted Section 8118 for the benefit of private defense contractors. The conference report that accompanied Section 8118 explains that the statute's primary purpose was to avoid unnecessary costs associated with the renegotiation of fixed-price contracts and to maintain congressional appropriations oversight authority. H.R. Conf. Rep. No. 498, 100th Cong., 1st Sess. 623-624 (1987).

(1915) (contract made in violation of the statute of frauds is enforceable); *Cessna Aircraft Co.* v. *Dalton*, 126 F.3d 1442, 1446, 1451-1452, 1454-1455 (Fed. Cir. 1997) (rejecting allegation that option contract was unenforceable due to alleged violation of the Anti-Deficiency Act and related funding regulations), cert. denied, 525 U.S. 818 (1998); *Whittaker Elec. Sys.* v. *Dalton*, 124 F.3d 1443, 1445-1446 (Fed. Cir. 1997) (rejecting allegation that option contract unenforceable as a violation of various procurement regulations, including one addressing "undue risks" in multi-year contracts); *LaBarge Prods., Inc.* v. *West*, 46 F.3d 1547, 1552-1556 (Fed. Cir. 1995) (contract enforceable despite violation of procurement regulations).

We are aware of no appellate decision (and petitioners cite none) that awards a contractor relief upon a fully performed contract on the theory that the government violated a funding restriction in an appropriations bill. Indeed, despite the multitude of opinions by the members of the Federal Circuit in this case, not one appellate judge has expressed the view that petitioners are entitled to any relief in this case.

2. There is no basis for petitioners' contentions (Pet. 1, 3, 13-17, 27) that the court of appeals' decision will adversely affect defense procurements. It is neither remarkable nor novel to hold contracting parties to the terms of their contract. *Madigan* v. *Hobin Lumber Co.*, 986 F.2d 1401, 1403 (Fed. Cir. 1993) ("A long line of our precedent has established that agreed-upon contract terms must be enforced."). This principle applies equally when the Government is a party to the contract. *General Bronze Corp.* v. *United States*, 338 F.2d 117, 124 (Cl. Ct. 1964) ("If the government is to be held strictly to its contractual obligations as though it were a private obligor, then, of course, it is entitled to insist

that those who contract with it shall be held to the same accountability.").

Petitioners also err in suggesting that the court of appeals' decision gives DOD "free reign to violate, whenever in its economic interests to do so," funding restrictions like those embodied in Section 8118. Pet. 15. That contention ignores both the ample tools available to Congress to ensure compliance with limits imposed on agencies during the appropriations process and the Anti-Deficiency Act. That Act makes it unlawful for federal officers to "make or authorize an[y] expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation." 31 U.S.C. 1341(a)(1)(A). Violators of the Anti-Deficiency Act are subject to administrative sanctions, including removal from office and criminal penalties, where the violation is knowing and willful. 31 U.S.C. 1349(a), 1350.

Likewise, the question presented does not recur with enough frequency to warrant this Court's review. The Navy awarded the contract at issue here over 15 years ago, just nine days after the passage of Section 8118. Moreover, no funding restrictions similar to Section 8118 have been included in DOD appropriations acts since Fiscal Year 1993. Although similar funding restrictions are now included in DOD's regulations, 48 C.F.R. 235.006, there is no basis for assuming that DOD officials would violate the Department's governing regulations. Indeed, petitioners only cite to three cases pending in the Court of Federal Claims involving Section 8118 or its successor provisions, and those cases do not necessarily present the same issues as in this case. For example, in *Northrop Grumman Corp. Military Aircraft Div.* v. *United States*, No. 96-760C (Fed. Cl. filed Dec. 2, 1996), the contract was awarded

two years before Section 8118 was adopted and the contractor entered into a bilateral contract modification releasing its claims based on Section 8118. And in *CTA Inc.* v. *United States*, No. 96-113C (Fed. Cl. filed Feb. 23, 1996), the contract was not for "research and development" and therefore did not trigger any prior written determination concerning allocation of contract risk.

3. In any event, this case does not present an appropriate vehicle to consider whether a violation of Section 8118 constitutes a basis for reformation of the price of a fully performed contract, because petitioners are not entitled to any relief in any event. As the court of appeals held in the alternative, AT&T waived whatever claims it had to recovery of additional sums by failing to seek a different allocation of risk when the contract was awarded. Pet. App. 11a-14a. Indeed, although AT&T is a sophisticated government contractor, with over 1,000 contracts worth over $2 billion (*id.* at 11a), at no time before the contract was awarded did AT&T either request a cost-reimbursement contract or ascertain whether the DOD had issued the required written determination under Section 8118. Those omissions are fatal to any claim of recovery of AT&T's costs.

First, it is far from clear that the Navy would have awarded the contract to AT&T had the contract been awarded on a cost-reimbursement basis. AT&T "successfully underbid technically superior competitors to win the RDA contract." Pet. App. 12a. AT&T therefore "agreed, in essence, to assume the risk associated with its lower technical rating." *Ibid.* Accordingly, "[h]ad the contract required cost-reimbursement, * * * the Navy would have assumed the risk that AT&T's inferior technical capability would result in more costly performance," and might "have avoided that risk by

awarding the RDA contract to one of AT&T's technically superior competitors—a contingency of which AT&T surely was aware." *Ibid.*

Second, the court found that reformation of the contract on a cost-reimbursement basis "would not further the mutual intent of the parties" because the issuance of a cost-reimbursement contract would have been inexorably linked to closer government supervision over contract performance. Pet. App. 13a. "By performing the RDA contract on a fixed-price basis, AT&T avoided the costs of more intrusive government supervision. * * * Moreover, unlike money, these bargained for rights are not reallocable after performance." *Id.* at 12a-13a.

Third, "reformation of the RDA contract would cure the Navy's [S]ection 8118 noncompliance only at the expense of creating non-compliance with other statutory and regulatory provisions." Pet. App. 13a. As the court of appeals explained, had the Navy awarded the contract on a cost-reimbursement basis, relevant statutory and regulatory provisions would have prohibited the Navy from entering the contract without a prior determination that "no lower cost alternative existed." *Ibid.* "In short, the proper time for AT&T to have raised the issues that it now presents was at the time of contract negotiation, when effective remedy was available." *Ibid.* Particularly in those circumstances, petitioners could not make a showing that it is "unconscionable for the government to require performance of the original terms." *Id.* at 18a n.2 (Newman, J., dissenting).

Petitioners suggest (Pet. 26) that the court of appeals' holding that petitioners' actions constituted a waiver conflicts with the principle that courts do not enforce illegal contracts. The decisions cited by peti-

tioners, *Kaiser Steel Corp.* v. *Mullins*, 455 U.S. 72, 81 n.6 (1982), and *McMullen* v. *Hoffman*, 174 U.S. 639, 658 (1899), however, hold simply that courts will not enforce an agreement that itself involves an undertaking to violate the law, regardless whether the party resisting enforcement has objected to the illegality. By contrast, the subject matter of petitioners' contract was entirely lawful and provides no basis for relieving petitioners of the bargain they struck with the government.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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